

02 Sep 2019 | Affirmation

## Fitch Affirms Sri Lanka's State Banks

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Fitch Ratings-Colombo/Hong Kong-02 September 2019: Fitch Ratings has affirmed the Long-Term Issuer Default Ratings (IDR) of the following Sri Lanka-based banks:

- National Savings Bank (NSB) at 'B'; Outlook Stable
- Bank of Ceylon (BOC) at 'B'; Outlook Stable

Fitch has also affirmed the National Long-Term Ratings of the following banks:

- NSB at 'AA+(lka)'; Outlook Stable
- BOC at 'AA+(lka)'; Outlook Stable
- People's Bank (Sri Lanka) at 'AA+(lka)'; Outlook Stable

At the same time, Fitch has affirmed and withdrawn the rating on BOC's proposed Basel III compliant Sri Lanka rupee-denominated subordinated debentures at 'AA(lka)', as the issuance has not taken place.

A full list of rating actions is at the end of this commentary.

### KEY RATING DRIVERS

#### IDRS, NATIONAL RATINGS, VIABILITY RATINGS AND SENIOR DEBT

The IDRs and National Long-Term Ratings of NSB and BOC and the National Long-Term Rating of People's Bank reflect Fitch's expectation of extraordinary support from the sovereign (B/Stable).

#### NSB

Fitch believes state support for NSB stems from its policy mandate of mobilising retail savings and investing them in government securities as well as its systemic importance and full government ownership. NSB is the only bank in Sri Lanka to carry an explicit government guarantee on its deposits, although the benefit of this is offset by the state's weak ability to provide support, as reflected in the low sovereign rating. Fitch has not assigned a Viability Rating to NSB as it is a policy bank.

The US-dollar senior unsecured notes issued by NSB are rated at the same level as the bank's Long-Term Foreign-Currency IDR, as they rank equally with the bank's other senior unsecured obligations. The notes have a Recovery Rating of 'RR4', which indicates typical historical recovery prospects of 31%-50%. This reflects Fitch's view of average recovery prospects for unsecured

senior creditors in case of default.

## BOC

Fitch expects support for BOC to stem from its high systemic importance, quasi-sovereign status, its role as one of the key lenders to the government and full state ownership.

BOC's Viability Rating reflects its thin capitalisation and asset-quality pressures amid a challenging operating environment. This is partly balanced by a stronger domestic funding franchise than the majority of sector peers. Fitch considers state support as BOC's primary rating driver, even though its Viability Rating is at the same level as its Support Rating Floor.

## People's Bank

Fitch expects support for People's Bank to stem from its high systemic importance, quasi-sovereign status, its role as one of the key lenders to the government and full state ownership.

## SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Ratings and Support Rating Floors of NSB and BOC reflect the state's ability and propensity to provide support to the banks given their high importance to the state and high systemic importance.

## SUBORDINATED DEBT

BOC's old-style Basel II and proposed Basel III compliant Tier 2 Sri Lanka rupee-denominated subordinated debt is rated one notch below its National Long-Term Rating to reflect the subordination to senior unsecured creditors.

## RATING SENSITIVITIES

### IDRS, NATIONAL RATINGS, VIABILITY RATINGS AND SENIOR DEBT

Changes to Sri Lanka's sovereign rating and/or in Fitch's perception of state support for the banks could result in a change in the banks' IDRs and the National Long-Term Ratings of NSB, BOC and People's Bank.

## NSB

A lower expectation of state support, a substantial change in NSB's policy role or a deviation from mandated core activities, indicating the bank's reduced importance to the state, could trigger a rating downgrade. However, this is not our base case scenario.

NSB's senior debt rating is sensitive to changes in the bank's Long-Term IDRs. The Recovery Rating

on the bank's notes is sensitive to Fitch's assessment of potential recoveries for creditors in case of default or non-performance.

## BOC

A downgrade of BOC's IDRs and National Long-Term Rating would most likely result from negative rating action on the sovereign, which could weaken the state's ability to support the bank.

BOC's Viability Rating may come under pressure if there is a continued decline in capitalisation through a surge in lending or high dividends. Further deterioration in the operating environment, leading to sustained weakening of BOC's key credit metrics, could also place negative pressure on its rating.

## SUPPORT RATING AND SUPPORT RATING FLOOR

Lower propensity of the state to support systemically important banks could result in downward pressure on BOC's and NSB's Support Ratings and Support Rating Floors, but Fitch believes this to be unlikely in the medium term. Changes in the sovereign rating could also affect BOC's and NSB's Support Ratings and Support Rating Floors.

## SUBORDINATED DEBT

BOC's subordinated debt ratings will move in tandem with its National Long-Term Rating.

The rating actions are as follows:

### National Savings Bank:

Long-Term Foreign-Currency IDR affirmed at 'B'; Stable Outlook  
Long-Term Local-Currency IDR affirmed at 'B'; Stable Outlook  
Short-Term Foreign-Currency IDR affirmed at 'B'  
National Long-Term Rating affirmed at 'AA+(Ika)'; Stable Outlook  
Support Rating affirmed at '4'  
Support Rating Floor affirmed at 'B'  
US dollar senior unsecured notes affirmed at 'B'; Recovery Rating at 'RR4'

### Bank of Ceylon:

Long-Term Foreign-Currency IDR affirmed at 'B'; Stable Outlook  
Long-Term Local-Currency IDR affirmed at 'B'; Stable Outlook  
Short-Term Foreign-Currency IDR affirmed at 'B'  
National Long-Term Rating affirmed at 'AA+(Ika)'; Stable Outlook  
Viability Rating affirmed at 'b'

Support Rating affirmed at '4'

Support Rating Floor affirmed at 'B'

Basel II compliant Sri Lanka rupee-denominated subordinated debentures affirmed at 'AA(Ika)'

Proposed Basel III compliant Sri Lanka rupee-denominated subordinated debentures affirmed at 'AA(Ika)'; Withdrawn

People's Bank (Sri Lanka):

National Long-Term Rating affirmed at 'AA+(Ika)'; Outlook Stable

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## ESG CONSIDERATIONS

BOC has an ESG Relevance Score of 4 for Corporate Governance due to concerns regarding ownership concentration with a 100% state shareholding and several related-party transactions with the state and state-owned entities. This negatively affects the bank's credit profile and is relevant to the rating in conjunction with other factors.

For more information on our ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

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### **Applicable Criteria**

[Bank Rating Criteria \(pub. 12 Oct 2018\)](#)

[National Scale Ratings Criteria \(pub. 18 Jul 2018\)](#)

## **Additional Disclosures**

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